BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WILLIAM AND PAULINE STEINBERG)

Appearances:

For Appellants: William Steinberg, in pro. per.

For Respondent: Lawrence C. Counts, Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of William and Pauline Steinberg against proposed assessments of additional personal income tax in the amounts of $2,062.25 and $135.79 for the years 1958 and 1962, respectively.

Appellant William Steinberg is an attorney at law and also the sole stockholder of Walter G. Brix, Inc., a corporation engaged in timber operations. In 1958 appellant received $56,286.25 from the corporation. During the income years ended March 31, 1958 and March 31, 1959, the earned surplus and undivided profits of the corporation amounted to $715,385.23 and $760,817.58, respectively.

Appellant has submitted lists and certain account records entitled "Walter G. Brix, Inc." indicating payments by him of corporate obligations and payments by him back to the corporation from 1959 through 1966, inclusive. Some of appellant's cancelled checks were also submitted, The payments back to the corporation are described in the records as loans to the corporation.

Appellant, however, has not furnished us with a copy of any written agreement entered into with Walter G. Brix, Inc. relative to the $56,286.25 or with any contemporaneous accounting entries indicating the actual nature of the agreement when the money was received.

Appellant guaranteed a $50,000 promissory note dated February 4, 1960. Interest was payable monthly from that date at 6 percent per annum. When no payments of principal or interest were made, an assignee of the note obtained a judgment on June 19, 1961 against appellant for "($50,000) principal, with interest at the rate of six per cent (6%) per annum from February 4th, 1960, until the date hereof, amounting to $4,180, ..." Interest on the judgment accrued at the rate of seven percent (7%) per annum in accordance with section 1916-1 of the Civil Code,, Appellant made a $5,000 payment to the assignee in partial satisfaction of the judgment on May 11, 1962. At that time interest on the judgment amounted to about $3,383..

In a federal audit the $56,286.25 received in 1958 from Walter G. Brix, Inc. was regarded as a taxable dividend. It was also determined therein that the $5,000 payment in 1962 was not deductible interest because it was paid on an obligation of another. Appellant did not contest the federal audit. Respondent made a similar determination, and this appeal resulted.

Appellant first contends that the amount received in 1958 was a loan for the purpose of paying various bills of the corporation in 1958 and thereafter.

Respondent's determination of a deficiency, based upon a federal audit report, is presumed correct and the taxpayer must show that it is erroneous. (Appeal of Nicholas H. Obritsch, Cal. St'. Bd. of Equal,, Feb. 17, 1959.) Furthermore where the withdrawer of corporate funds is in substantial control of the corporation, special scrutiny is given. (Elliott J. Roschuni, 29 T.C. 1193, aff'd, 271 F.2d 267, cert. denied, 362 U.S. 988 [4 L. Ed. 2d 1021); W. T. Wilson, 10 T.C. 251.) Relief from such burden of proof should not be given lightly where the facts and the evidence are peculiarly subject to the control and knowledge of the taxpayer. (Wiese v. Commissione 93 F.2d 921, cert. denied, 304 U.S. 562 [82 L. Ed. 1529].)

In determining whether the 1958 withdrawal was specifically designated for corporate use, the primary consideration is the intention of appellant and the corporation at the time the withdrawal was made. (Nasser v. United States, 257 F. Supp. 443.) The documentary evidence presented by appellant does not prove that the $56,286.25 payment constituted a loan from the corporation.. No corporate minutes have been presented which describe the agreement between the parties; no 1958 account records were submitted characterizing the payment when it was made to appellant; and it has not been established that the amount withdrawn was placed in a special trust account. Furthermore, an indefinite intention as to use for corporate purposes at some time in the future is insufficient where the withdrawal places the money in the taxpayer's

absolute control and subject to his absolute discretion as to its use. (See Gurtman v. United States, 237 F. Supp, 533.)

Under the circumstances, we must conclude that appellant has not met the burden of establishing nondividend status of the 1958 payment.

With respect to the $5,000 partial payment of a judgment in 1962, appellant contends that it is a deductible interest payment, Respondent's determination of nondeductibility is again presumptively correct. Nevertheless, judgment constitutes a debt and interest paid thereon bay the judgment debtor is deductible, (Joseph W. Bettendorf, 3 B.T.A. 378,) Accordingly, appellant is entitled to a $3,383 deduction for the interest which accrued on the judgment.. Appellant has not established that the remaining balance of $1,617 was a deductible expense.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in'this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of William and Pauline Steinberg against proposed assessments of additional personal income tax in the amounts of $2,062.25 and $135.79 for the years 1958 and 1962, respectively, be and the same is hereby modified in that appellants are to be allowed an interest expense deduction in the amount of $3,383 for the year 1962. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 25th day of March, 1968, by the State Board of Equalization,

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary